

Increasing Access to Credit through Reforming Secured Transactions in the MENA Region

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Abstract

This paper provides a comparative summary of secured transactions systems related to the use of movable property as collateral in the MENA region vis à vis international practices in countries with modern secured transactions systems. The paper sets out the importance of introducing reforms in the area of secured transactions with the objective of increasing access to credit for businesses, particularly SMEs. The MENA region

clearly lags behind all other regions in the introduction of secured transactions reforms. The paper summarizes many of the weaknesses common across the region. The two main critical areas that need urgent reforms are the creation of modern secured transactions laws and electronic movable collateral registries, and the need to improve enforcement mechanisms for security interests in movable property.

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Table of Contents

1	Secured Transactions and Movable Collateral: Current State in MENA	3
2	Secured Transactions: Legal and Institutional Framework	9
2.1	Snapshot at Modern Secured Transactions Systems	9
2.2	Scope of the Law	12
2.3	Creation of Security Interests	16
2.4	Publicity and Registration of Security Interests	17
2.5	Priority Scheme for Creditors	23
2.6	Enforcement of security interests: seizure of secured assets in cases of loan default....	24
2.7	Enforcement of security interests: sale of assets in cases of default	30
2.8	Summary of Findings and Recommendations	33
	Bibliography	39
	Annex 1	41

Figures

Figure 1: Firms Access to Credit Around the World	3
Figure 2: Better Secured Transactions Systems = More Credit and Fewer Defaults	7

Tables

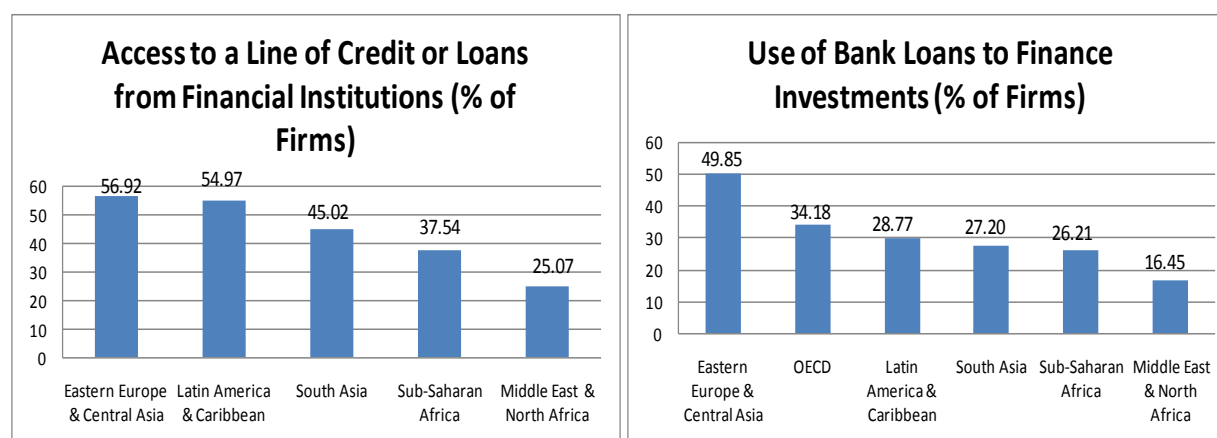
Table 1: Loans Requiring Collateral in the MENA Region (%)	4
Table 2: Doing Business Legal Rights Index in MENA in 2009	11
Table 3: Cross-regional Average Scores on Legal Rights	12
Table 4: Types of Assets Typically Used as Collateral in Countries with Modern.....	13
Table 5: Overall Secured Transactions Scope in MENA Countries	14
Table 6: Regional Comparison on the Scope of Secured Transactions	16
Table 7: Mapping of Collateral Registries	21
Table 8: How Problematic is for Banks in the MENA	22
Table 9: Priority of Secured Creditors vis a vis Others Creditors in	24
Table 10: Out of Court Enforcement in MENA vs. Other Regions	31
Table 11: Percentage of Banks in MENA that Consider	30

1 Secured Transactions and Movable Collateral: Current State in MENA

Access to credit is crucial for economic growth and is the engine for private sector development. While access to credit varies from one jurisdiction to another, **constrained access to finance remains among the top three limitations on private sector growth in the developing world.** More than half of private firms in emerging markets have no access to credit. The number of firms that use loans to finance investments in the developing world is half the number of those of firms operating in OECD countries.¹

Creditor protection through modern secured lending legal regimes is associated with higher ratios of higher private sector credit to GDP (2006, Djankov et al). Increasing the protection of creditor's rights and enforcement mechanisms can lead to a considerable increase in private sector credit to GDP.² As illustrated in the figure below, the MENA region clearly lags behind the rest of the world in firms' access to private credit.

Figure 1: Firms Access to Credit Around the World³



In the World Bank's Enterprise Surveys, the MENA region has the lowest percentage of firms with credit lines or loans from financial institutions, at 25.07%, compared to 56.92% for Eastern Europe and Central Asia (ECA), 54.97% for Latin American & the Caribbean (LAC), and 45.02% for South Asia. The percentage of firms in MENA using banks to finance investments was also the lowest. Sixteen (16.45) percent of firms in MENA use bank financing for investment, compared to 34.18% in the OECD, and 49.85% in ECA. Based on the numbers in the same survey, MENA firms also identify access to finance as a major constraint, more than in

¹ See World Bank Group Enterprise Surveys.

² See "Private Credit in 129 Countries", Simeon Djankov, Caralee McLiesh and Andrei Schleifer, 2006.

³ Based on the latest datasets available on www.enterprisesurveys.org on the date of access (February 10, 2010)

any other region except Sub-Saharan Africa.⁴ On average, in the MENA countries, 34 percent of firms identified access to finance as major constraint to economic activities.⁵ For countries such as Algeria and Lebanon, this constraint is even more severe (50%⁶ and 42%⁷), for others, such as Oman (25%⁸), the constraint is lower, but a barrier to business activities nonetheless. Improving secured transactions regimes has helped alleviate this constraint in other countries and can reasonably be expected to do the same for the MENA countries.

Insufficient Suitable Collateral is Among the Top Reasons for Difficulty in Accessing Finance.⁹ Firm level surveys conducted in developing countries help explain why obtaining finance is difficult. A common trend among the firms indicates that credit applications are mostly rejected due to insufficient collateral, i.e. unacceptable or unsuitable collateral. In many cases, business owners did not even bother applying for loans, because they were certain that they could not meet the collateral requirements often requested by banks.¹⁰ As illustrated by the table below, more than 80% on average of the loans granted in MENA by financial institutions require some type of collateral. An in-depth analysis indicates that availability of collateral is frequently not the source of the problem; it is the ability of translating valuable assets into productive use. While in the developing world 78% of the capital stock of a business enterprise is typically movable assets such as machinery, equipment or receivables and only 22% immovable property, financial institutions are reluctant to accept movable property as collateral. Banks heavily prefer land and real estate as collateral (suitable collateral).¹¹ This dichotomy is clearly present in the MENA region, where the gap is the lack of reliable frameworks for financial institutions to accept more movable property as collateral.

⁴ See World Bank Group Enterprise Surveys

⁵ Based on the latest datasets available on www.enterprisesurveys.org on the date of access (February 10, 2010)

⁶ Enterprise Surveys, 2007

⁷ Enterprise Surveys, 2006

⁸ Enterprise Surveys, 2003

⁹ See “Secured Transactions Systems and Collateral Registries”, Chapter 1: Economic Rationale, World Bank Group, January 2010

¹⁰ See “Reforming Collateral Laws to Expand Access to Finance” Fleisig, Safavian, De La Pena, 2006.

¹¹ “Reforming Collateral Laws to Expand Access to Finance” Fleisig, Safavian, De La Pena, 2006.

Table 1: Loans Requiring Collateral in the MENA Region (%)

Country	Loans to Firms requiring collateral (%)
Algeria	79
Egypt	84.4
Jordan	97.6
Lebanon	67.5
Morocco	90
Oman	73.8
West Bank/Gaza	84.5

Source: WB Enterprise Surveys 2006-10

The importance of collateral is also supported by empirical studies conducted with financial institutions in OECD and emerging market countries on the role of collateral in the overall credit decision and risk management process. Prevailing lending practices in a diverse group of countries reveal that, while their primary focus is on the capacity to repay the loan, availability of collateral is also a condition precedent to lending.¹²

Collateral and credit information¹³ are critical elements of a functioning credit system. The lack of these elements creates information asymmetry and a risk premium for borrowers who want to access credit. Credit is constrained in markets with information asymmetry (Stiglitz and Weiss, 1981). Moral hazard and adverse selection will be reduced if collateral frameworks and credit information systems are improved, creating a more robust financial sector in the region.

Part of the Solution to Increase Access to Credit Lies in Reforming Secured Transactions Laws and Registries. Providing legal structures through which movable assets in emerging markets can be effectively used as collateral will significantly improve access to finance to those firms that need it the most. Even in the most advanced jurisdictions where reliable credit information and a wide range of financial products are available, only the largest and best connected businesses can obtain unsecured loans. The rest have to offer collateral. A sound legal and institutional infrastructure is critical to maximize the economic potential of movable assets so that they can be used as collateral. Effective secured transactions laws are a crucial component of a healthy financial sector and business climate. In their absence, entrepreneurs are unable to leverage current assets into

¹² See “How to Expand Credit to SMEs – Creative Solutions to the Puzzle of Collateral Lending”, Alvarez de la Campa, Alejandro. IFC Smart Lessons, Washington D.C. 2007.

¹³ Credit bureaus, which maintain information on borrowers, have been developed in several MENA countries. Banks can make more prudent lending decisions if there is a repository of information on borrowers regarding their creditworthiness—their history of repaying debts. However, a number of MENA countries are still missing proper credit information system deepening the information asymmetry gap.

capital for investment. Modern secured transactions systems allow the use of movable assets (both tangible and intangible) such as equipment, inventory, accounts receivable, cash flows, livestock, crops and others as collateral in exchange for loans.

Economic analysis also suggests that small and medium-sized businesses in countries that have stronger secured transactions laws and registries have greater access to credit, better ratings of financial system stability, lower rates of non-performing loans, and a lower cost of credit. Modern secured transactions systems also contribute to private sector development by:

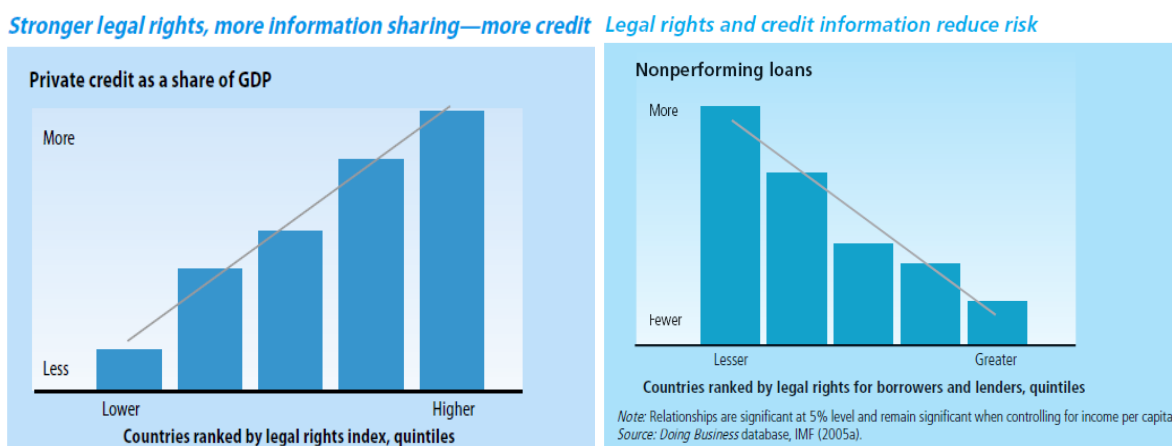
- **Increasing the level of credit:** In countries where security interests are perfected and there is a predictable priority system for creditors in cases of loan default, credit to the private sector as a percentage of GDP averages 60% compared with only 30% to 32% on average for countries without these creditor protections.¹⁴
- **Decreasing the cost of credit:** In industrial countries, borrowers with collateral get nine times the level of credit given their cash flow compared to borrowers without collateral. They also benefit from longer repayment periods (11 times longer) and significantly lower interest rates (50% lower).¹⁵

Further economic analysis suggests that small and medium-sized businesses in countries that have stronger secured transactions laws and registries have greater access to credit, better ratings of financial system stability, lower rates of non-performing loans (see Figure 2), and a lower cost of credit. The end result is higher productivity and more growth.

¹⁴ Safavian, Mehnaz, Heywood Fleisig and Jevgenijs Steinbuks, 2006. "Unlocking Dead Capital: How Reforming Collateral Laws Improves Access to Finance." Private Sector Development Viewpoint, No. 307, World Bank, March 2006.

¹⁵ Chaves, Rodrigo, Nuria de la Pena and Heywood Fleisig, 2004. "Secured Transactions Reform: Early Results from Romania." CEAL Issues Brief, Center for Economic Analysis of Law, September 2004.

Figure 2: Better Secured Transactions Systems = More Credit and Fewer Defaults



Source: WBG, “Doing Business 2006/2007”

Lending practices and secured transactions in the MENA region. In the MENA region, the prevailing model of lending is still for loans to be given on the basis of personal knowledge of borrowers. Collateral-based lending, where it happens, is more often based on real estate than on movable collateral.¹⁶ Movable collateral based lending is limited to a few financing mechanisms: vehicle financing, “fonds de commerce” or enterprise pledge, retention and transfer of title, security interests in bank accounts and salaries, and in some countries, company shares and natural resource extraction licenses. Vehicle financing and the use of fonds de commerce are widely spread throughout the region. However, fonds de commerce (which are widely accepted in the Maghreb due to the civil law legal system) are generally a secondary or complementary type of security to the main collateral accepted (immovable property). Leasing exists, and though the leasing industry is still nascent, it has the potential to expand as secured transaction infrastructure improves. It appears to be the most visible in Morocco and Tunisia.¹⁷ Jordan and Yemen have recently passed leasing laws which call for creation of the notice registry for leased assets.

A unique feature of lending practices in the MENA region compared to other regions is the importance of Islamic Finance. The influence of Islamic Finance is stronger in the Gulf countries than in other countries of the Maghreb for example, where Islamic banks are minor players in the market. While consensus is not unanimous among practitioners about the complete compatibility of Islamic finance principles and the modern concepts of secured

¹⁶ Observation based on reports of bankers and consultants who have informally surveyed bankers.

¹⁷ See “Financial Sector Reforms and Prospects for Financial Integration in Maghreb Countries”, IMF Working Paper, WP/07/125, May 2007.

transactions, recent studies lead us to believe that it is possible to have an effective modern secured transactions system in an Islamic finance environment (see Box 1).

Box 1: Islamic Finance and Secured Transactions¹⁸

Islamic Finance has become a hot topic in commercial law discussions. Islamic jurisprudence governing secured transactions is extensive (*rahn*). A well known codification is found in the Ottoman Civil Code of 1877, also referred to as the *Majalat Al-Ahkam Al-Adiyah*, or the *Majalla*.

A recent working paper by an American professor advocating a secured transactions system for Iraq, attempts to demonstrate that contrary to common opinion, the *shari'ah* (Islamic Law) is actually compatible with a modern secured transactions regime. In the working paper, he identifies five elements of a progressive secured transactions system:

1. Creation of non-possessory security interests
2. Creation of security interests in future assets
3. Securing of future debts
4. Clear rules which give a secured party priority over competing claimants
5. Prompt enforcement of security interests without a court order.

He then analyzes the relevant Islamic jurisprudence, interpreting it to allow each of these 5 elements to be developed. For example, he argues that the hadith referring to possession as evidence of pledge, does not prohibit a pledge without possession, but can be interpreted to mean that possession is only necessary as evidence of the loan if there is not a written contract. He goes on and similarly provides arguments that shari'ah can be interpreted to allow all five of the elements listed, which are all critical elements of a modern secured transactions system.

Some countries in the MENA regions are strongly influenced by Islamic principles of finance and transactions are required to be in compliance with Islamic law. Interpretations of shari'a are not always consistent, with each bank taking its own position as to whether a particular type of transaction is compliant. The main shari'a principles applied in commercial transactions are prohibitions on (i) *riba* (interest), (ii) *gharrar* (excessive uncertainty or speculation) and (iii) *jahl* (ignorance of material terms). Courts do unwind transactions if they find them to be noncompliant, and interpretations vary by judge, judicial body, and bank. The fear of having their contractual agreements rewritten leads to uncertainty in transactions. It is, therefore, important to create awareness about the possibility of co-existence between the principles of Islamic finance and the principles of modern secured transactions.

¹⁸ See "Iraq, Secured Transactions & The Promise of Islamic Law", by Mark Sundahl, Cleveland-Marshall College of Law, Research Paper 07-138, September 2007.

2 Secured Transactions: Legal and Institutional Framework

2.1 Snapshot at Modern Secured Transactions Systems

A modern and efficient secured transactions system should be built around the following principles or pillars that should be reflected in a secured transactions law:

- **Scope:** the types of legal structures that can be used to secure obligations (e.g. security interest, pledge, mortgage, etc.); the types of transactions that should be considered within the scope of the law (loans secured with movable property, retention of title, financial leasing, assignment of receivables, consignments, etc); the types of movable property that may be used as security; and the types of debtors who may give security in movable property.
- **Creation:** the legal requirements for giving and taking a right against movable property to secure an obligation.
- **Priority:** the rules that determine the relative rights among conflicting claims against movable property.
- **Publicity/registration of security interests:** the means of making a claim against movable property transparent to third parties, commonly provided by registration in a public registry, by taking possession or control of the movable property, by direct notice, or by other means. An efficient registry is characterized by having a single electronic database with all information about existing security interests in movable property, accessible to the general public in real time for a reasonable fee.
- **Enforcement:** the process for enforcing a claim against movable property when the debtor defaults on the secured obligation. Enforcement mechanisms should include the possibility of enforcing out of court.

The following sections provide an overview of standard modern international practices in these different areas and how do they compare with the current secured transactions frameworks in MENA. The main sources of data contained in the report are related to (i) internationally accepted practices on modern secured transactions systems (The World Bank Principles on Insolvency and Creditor's Rights and the UNCITRAL Legislative Guide on Secured Transactions); (ii) Data survey from the World Bank Enterprise Surveys, Doing Business Report and SME Lending Surveys to Financial Institutions in MENA; (iii) country specific diagnostic reports from the World Bank Group and other multilateral organizations. Given the complexity of providing an overview of the secured transactions system in each country limiting the paper to a manageable size, the report focuses on general principles and how they are applied in the region.

The World Bank *Doing Business* report measures to a certain degree the quality of secured transactions systems through the Legal Rights Index¹⁹ which is part of the Getting Credit indicator. While not every aspect of a comprehensive secured transactions system is covered by the criteria of the Legal Rights Index, it covers a number of aspects related to: (i) the scope of the law (possessory and non-possessory security rights, general description of assets, debts and obligations, security interests in future assets, extension of the security interests to the products and proceeds); (ii) the priority scheme for creditors (outside and in bankruptcy proceedings); (iii) the publicity mechanism through the registration of notices in a collateral registry, and; (iv) the enforcement mechanisms, including out of court enforcement. The Legal Rights Index has some important gaps in how security interests are created and perfected, in measuring which countries have a good registry system and also in determining the types of transactions and the types of parties that should be covered by the secured transactions law. In addition to this, there is not complete consensus among international experts in a couple of the criteria, including the exempt from an automatic stay on enforcement and the absolute priority of secured creditors. Other minor aspects are also missing given the limitations of the methodology. However, despite these gaps, the Legal Rights Index proves to be a good benchmarking tool to assess creditors' rights and secured transactions in a given jurisdiction and the ranking of the MENA countries reflect relatively well the regional overview that has been validated by some stand alone diagnostics in specific countries.

An overview of the Doing Business' Legal Rights Index indicator for the region in 2009 illustrates that secured transactions systems are still hugely underdeveloped. Individually, there is not a single country in the region that has introduced reforms in its secured transactions system, which is illustrated by the position of individual countries in the ranking (see Table 2). The first group of countries in the ranking (Jordan, UEA, Saudi Arabia, Oman, Bahrain, Kuwait) are 106 in the overall ranking, while West Bank & Gaza is the last country with a score of 0 in Legal Rights. The infrastructure for modern secured transactions regimes is largely missing in the MENA countries.

¹⁹ The strength of legal rights index measures the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders and thus facilitate lending.

Table 2: Doing Business Legal Rights Index in MENA in 2009

	ALG	BHR	DJI	EGY	IRN	IRQ	JOR	KWT	LB	MOR	OMN	QAT	SAU	SYR	TUN	UAE	WBG	YEM	% of Yes
Index (0-100)	3	4	1	3	4	3	4	4	3	3	4	3	4	1	3	4	0	2	
Rank	128	106	178	128	106	128	106	106	128	128	106	128	106	178	128	106	182	168	
1	Y	Y	Y	Y	Y	Y	Y	Y	N	Y	Y	Y	Y	N	Y	Y	N	Y	83.3
2	N	N	N	N	N	N	N	N	N	N	N	N	N	N	N	N	N	N	0.0
3	Y	N	N	Y	N	N	N	Y	Y	Y	N	N	N	N	Y	Y	N	N	38.9
4	N	N	N	N	N	N	N	N	N	N	N	N	N	N	N	Y	N	Y	11.1
5	Y	Y	N	Y	N	N	N	Y	Y	Y	Y	Y	Y	N	N	Y	N	N	55.6
6	N	Y	N	N	N	N	N	Y	N	N	Y	N	N	N	Y	N	N	N	22.2
7	N	N	N	N	Y	N	Y	N	N	N	N	N	Y	N	N	N	N	N	16.7
8	N	N	N	N	N	Y	Y	N	N	N	N	N	N	N	N	N	N	N	11.1
9	N	N	N	N	Y	Y	Y	N	Y	N	Y	N	Y	Y	N	N	N	N	38.9
10	N	Y	N	N	Y	N	N	N	N	N	N	Y	N	N	N	N	N	N	16.7

Source: Doing Business 2010

Index Components:

- 1 Can any business use movable assets as collateral while keeping possession of the assets; and any financial institution accept such assets as collateral?
 - 2 Does the law allow businesses to grant a non possessory security right in a single category of revolving movable assets, without requiring a specific description of the secured assets?
 - 3 Does the law allow businesses to grant a non possessory security right in substantially all of its assets, without requiring a specific description of the secured assets?
 - 4 May a security right extend to future or after-acquired assets, and may it extend automatically to the products, proceeds or replacements of the original assets?
 - 5 Is a general description of debts and obligations permitted in collateral agreements, so that all types of obligations and debts can be secured by stating a maximum amount rather than a specific amount between the parties?
 - 6 Is a collateral registry in operation that is unified geographically and by asset type, as well as indexed by the grantor's name of a security right?
 - 7 Do secured creditors have absolute priority to their collateral outside bankruptcy procedures?
 - 8 Do secured creditors have absolute priority to their collateral in bankruptcy procedures?
 - 9 During reorganization, are secured creditors' claims exempt from an automatic stay on enforcement?
 - 10 Does the law authorize parties to agree on out of court enforcement?
- When compared across regions, MENA is clearly behind all of the other regions, including Sub-Saharan Africa (see Table 3). Egypt, Jordan, West Bank and Gaza, Bahrain and Qatar have begun to consider substantial overhaul of their systems, and are in early stages of reform.

Table 3: Cross-regional Average Scores on Legal Rights

	East Asia & Pacific	Europe & Central Asia	High income: OECD	Latin America & Caribbean	Middle East & North Africa	South Asia	Sub- Saharan Africa
Legal Right Index (0-10)	5.7	6.6	6.8	5.5	3.3	5.3	4.6
1	100.0	100.0	100.0	90.5	83.3	85.7	97.4
2	66.7	57.1	63.6	28.6	0.0	71.4	41.0
3	75.0	57.1	63.6	42.9	38.9	85.7	92.3
4	50.0	39.3	72.7	61.9	11.1	71.4	41.0
5	83.3	75.0	100.0	81.0	55.6	57.1	87.2
6	50.0	67.9	40.9	23.8	22.2	14.3	23.1
7	58.3	75.0	59.1	38.1	16.7	14.3	25.6
8	33.3	71.4	59.1	4.8	11.1	14.3	15.4
9	41.7	35.7	36.4	47.6	38.9	42.9	30.8
10	58.3	75.0	77.3	33.3	16.7	85.7	41.0
Average	61.7	65.4	67.3	45.2	29.4	54.3	49.5

Source: *Doing Business* 2010

2.2 Scope of the Law

Modern secured transactions systems include a broad scope of what the system should be based on, including (i) the types of parties, particularly debtors, to which the law applies; (ii) the types of movable assets to which the law applies, and; (iii) the types of contractual agreements and obligations that may be secured. UNCITRAL's Legislative Guide on Secured Transactions includes a very comprehensive and clear recommendation on what the scope of the law should be (see Annex 1).

Types of parties. All natural (including consumers) and legal persons (businesses) should be allowed to create security interests on movable property. In some jurisdictions, natural persons (including sole proprietorships) and some legal person may not use their movable assets as collateral. In jurisdictions with the UK's English common law system (India, Bangladesh, Sri Lanka, etc) in which security interests are registered in the Company Registry, non-incorporated companies are excluded from the formal financing channel. Likewise, jurisdictions with a French

civil law system such as many countries in Africa (Mali, Madagascar, Togo, Chad, etc) and some in the Middle East (Morocco, Tunisia, Algeria, Syria, etc), face similar issues since security interests for businesses are registered in the “Registre de Commerce et du Credit Mobilier” (RCCM), limiting registration of security interests to legal persons described in the commercial code. The recommended practice is to create a single depository of security interests for all types of legal and natural persons.

Types of assets. A secured transactions law is most useful when it broadly defines the scope of permissible collateral to include tangible and intangible property of any nature, assets that do not yet exist or are owned by the debtor (future assets), and a changing pool of assets. A single, unitary concept of security interest should be adopted for granting a real right in any movable property from the debtor to the creditor in order to secure an obligation of the debtor. Moreover, creditors should be able to describe the collateral generically to allow the possibility of creating security interests in future assets and fluctuating assets, a prerequisite for modern inventory and receivables financing. Requiring more specific descriptions prevents future and fluctuating assets from being used as collateral, and is cumbersome even for existing assets that are not uniquely identifiable (e.g., raw materials). Table 4 illustrates examples of what could be used as movable property in jurisdictions with modern secured transactions systems.

Table 4: Types of Assets Typically Used as Collateral in Countries with Modern Secured Transactions Systems

Tangible movables	Intangible movable property
Machinery and equipment: industrial and non-agro machinery, agro-machinery and equipment	A single accounts receivable
Inventory, i.e., goods for sale	Multiple accounts receivable
Motor vehicles	Investment property (stocks and securities, options and futures, bonds, derivative products, etc)
Agricultural products: fertilizers, crops and other agricultural yields, livestock, fish farm, etc.	Intellectual property (e.g., patent rights, trademarks)
Consumer goods: office equipment, computers, servers, screens, projectors, furniture, etc.	Insurance policies
Minerals, hydrocarbons, timber	Membership and partnership interests in business entities and cooperative shares
Medical equipment	Futures (e.g., crop futures, future acquisitions of collateral described in the agreement, and unborn livestock)
Jewelry, precious stones	Bank accounts

In MENA, immovable property is still used as the prevalent form of collateral. The majority of banks in the MENA region accept movable property as collateral. A recent World Bank survey to financial institutions in the MENA region shows that on average 67% of banks accept

movable property as collateral.²⁰ However, based on interviews with banks in the region, loans only secured with movable collateral are not widely used, due to the inability of banks to secure the right over the asset through a collateral registry and due to the difficulties in enforcing security interests in movable property. Movable property is usually accepted as a secondary type of collateral and usually taken as a complement to immovable assets (real estate property). Loans secured with assets such as receivables and inventory, are used even less often.

None of the MENA countries have a modern law on secured transactions. Most of the countries have obsolete and fragmented secured transactions provisions governed by different laws that have not been reformed in many years. This means that often times, the scope of assets that can be used is limited and some jurisdictions have established “*numerus clausus*” of assets that can be considered movable collateral. This concept is against the modern principle of secured transactions in which all types of assets should be able to be used as collateral as long as they can be given a value. Among the MENA countries, different jurisdictions allow different types of movable assets to be used as collateral. In general, tangible movable assets are widely accepted, while intangibles such as account receivables are less used.

With regard to *tangible movable property*, according to the World Bank Hawkamah report, vehicles are viable collateral in most MENA countries including Algeria, Morocco, Egypt, Jordan, Lebanon, Saudi Arabia, Tunisia, Qatar, the UAE, West Bank & Gaza and Yemen since vehicle registration is generally well-developed, although some data from different countries indicate that registration of security interests in vehicles is still an issue.²¹ A pledge over an entire enterprise, the “*fonds de commerce*”, is also possible in many countries, including in Morocco, UAE, Tunisia, Palestine and Algeria. Enterprise pledges are the only way to take a pledge on a floating pool of assets, rather than identifying each individual piece of collateral (see Table 5 for an overview of scope of assets in MENA).

²⁰ World Bank MENA SME Lending Survey 2010

²¹ *Hawkamah Report*, Chapter 7 Egypt, Chapter 8 Jordan, Chapter 10 Lebanon, Chapter 12 Palestine, Chapter 13 Qatar, Chapter Chapter 15 UAE.

Table 5: Overall Secured Transactions Scope in MENA Countries

Country	Broad pool of assets accepted as collateral with generic description	Mechanisms to secure all movable of a company (Enterprise charge, nantissement de fonds de commerce)	Future assets, products and proceeds
Algeria	N	-	-
Bahrain	N	Y	N
Egypt	N	Y	N
Iraq	N	N	N
Iran	N	N	N
Jordan	N	N	N
Kuwait	N	Y	N
Lebanon	N	Y	N
Libya	-	-	-
Morocco	N	Y	N
Oman	N	N	N
Qatar	N	N	N
Saudi Arabia	N	N	N
Syria	N	N	N
Tunisia	N	Y	N
UAE	N	Y	Y
West Bank & Gaza	N	-	-
Yemen	N	N	Y

Source: *Doing Business* 2010

With regard to *intangible movable property*, the use of these types of assets as collateral is much more limited, although a few countries allow the use of receivables, securities, bank accounts and salaries as collateral.

Another inhibitor to expanding the use of movable property as collateral is the requirement to describe each piece of collateral specifically. Certain assets, such as inventory or accounts receivable, exist as a pool, but the individual elements are constantly changing as a matter of daily business. It is impossible to make new adjustments to a security agreement for each change. Floating pledges, where a changing pool of assets such as inventory or accounts receivable is used as collateral, without the need to document each individual piece of collateral, though common in more advanced financial systems, also by and large do not exist in the MENA region. Table 6 illustrates how the MENA region compares with others in the scope of their laws governing secured transactions.

Table 6: Regional Comparison on the Scope of Secured Transactions

	East Asia & Pacific	Europe & Central Asia	High income: OECD	Latin America & Caribbean	Middle East & North Africa	South Asia	Sub- Saharan Africa
Legal Rights Index (0-10)	5.7	6.6	6.8	5.5	3.3	5.3	4.6
Non-possessory security interests	100.0	100.0	100.0	90.5	83.3	85.7	97.4
Security interests in revolving assets with general description	66.7	57.1	63.6	28.6	0.0	71.4	41.0
Security interests in all assets with general description	75.0	57.1	63.6	42.9	38.9	85.7	92.3
Future assets, products and proceeds	50.0	39.3	72.7	61.9	11.1	71.4	41.0
General description of debts and obligations	83.3	75.0	100.0	81.0	55.6	57.1	87.2

Types of contractual agreements. In addition to the restriction on the types of assets, none of the countries in MENA have adopted the “functional approach” to secured transactions, which should allow equal treatment to all transactions secured by movable property no matter what the nature of them is (financial leases, consignments, assignment of receivables, secured sales contracts, loans secured with movable property, retention of title, etc.) with regard to publicity and priority vis a vis third parties. This is a critical concept to avoid having a system with hidden liens due to the lack of publicity of some of them.

2.3 Creation of Security Interests

Formal requirements for creating security interests should be kept minimal. Modern secured transactions laws recognize parties' ability to create a security interest as a real right in movable collateral by agreement. A written agreement signed by both debtor and creditor, identifying the collateral and the secured obligation should be sufficient to create a security interest in movable property. Registration of that security interest in the collateral registry establishes the priority and effectiveness against third parties, but should not be a requirement for a security interest to be valid and enforceable. No special terminology, forms, or notarization should be required, as these elements create no value but add additional costs to the loan transaction, and these costs end up being passed on to the borrowers, increasing the overall cost of credit. Parties should have the freedom, within the limitation of the law, to address through the security agreement all matters relating to their relationship, including defining warranties and covenants, events of default, and remedies.

In a number of countries in MENA, the creation of security interests that are enforceable are cumbersome and require unnecessary formalities that make the system more burdensome for creditors to expand lending secured with movable property. Lebanon, Oman, Saudi Arabia, Tunisia and Yemen for example require that security interests be registered in specific institutions (courts, notaries) in order to be enforceable.²² A credit agreement between creditor and debtor should be enforceable without any other required formalities. A distinction must be made between enforceable agreements and the priority of a claim against third parties (for which the registration in a public registry is necessary).

2.4 Publicity and Registration of Security Interests

A key feature of a modern secured transactions law is an efficient centralized registration system. Such movable collateral registration serves two functions: (1) it notifies third parties of the existence of the security interest and (2) it establishes the priority status of a security interest based on the date of registration. Unlike title (ownership) registries such as a land registry, a secured transactions registration system does not create or transfer property rights. The registry under a modern system is known as a “notice” registry. That is, it is a registry in which only a simple notice of the essential facts of the secured transaction, i.e. the identity of the debtor, the identity and contact information for the secured creditor, a general or specific description of the collateral and the amount of the loan secured by the collateral. A number of best practice principles for registries have been developed from the experiences of countries that have successfully implemented modern secured transactions systems. The notice registration concept for a collateral registry was developed with the first modern secured transactions laws established in the 1950s in the United States (UCC Article 9). Other countries such as Australia, Canada, New Zealand, Albania, Bosnia, Slovakia, Cambodia, China, Romania, Peru that have adopted modern secured transactions laws have also adopted some version of notice registration. A modern registry should be characterized by the following principles illustrated in Box 2.

²² See *Hawkamah Reports* for Lebanon, Saudi Arabia, Oman and Yemen and *Legal Benchmarks for Monitoring Implementation of Euro-Mediterranean Association Agreements*, Draft August 5, 2004, unpublished, Annex 4c Secured Lending, Tunisia.

Box 2: Key Provisions that Laws and Regulations Should Include About the Secured Transactions Registration System

- *Registry Mandate:* the registry is the place to register security interests in movable assets. An institution must be assigned responsibility for its operation
- *Centralized registry* for the whole jurisdiction. Decentralized registries by region are very costly and less effective as all the information needs to be linked into a single dataset.
- *Unified registry for all security interests in movable property.* The registry should include notices of all types of security interests (including financial leases, assignments of receivables, etc.) in all types of movable property of all kinds of debtors.
- *Electronic registration and web based systems:* the electronic record is the official record (particularly important with web based systems). It is critical that registration of notices become effective in real time, and that searches reflect real time information on security interests in movable property so that creditors can make informed financing decisions and protect their right on the collateral. This can only be effectively achieved through a web based system with live registration of notices.
- *Public record and public access to the information:* access to the information available to the general public without proof of any particular need, from widely available access points, and without undue delay. The registry should be accessible at hours other than normal business hours of the registry.
- *Notice registration.* Registration requirements must be kept as simple for the user as possible in order to eliminate errors and to encourage use. The information that needs to be entered is usually limited to information on the creditor, the debtor, the amount of the loan (which is usually entered but not disclosed to the public) and the description of the collateral. There is no need to register any documents (such as the credit agreement), no formalities such as signature or notarization are required
- *Types of notice that may be registered and duration of notices.* The registry should allow for different types of registrations (initial notice, amended notice, termination or discharge, continuation of effectiveness or extension and objection to registration by debtor) and for determining the duration of a registration.
- *Cost effectiveness:* The fees charged by the registry for registration and searching should be limited to the level required to recover the costs of operation of the registry. The transactional cost must not deter users from registering. The fee should be a fixed amount for each registration or search independently of the nature or amount of the loan. Reasonable fees would generally range between \$5 and \$10.
- *Registry duties and authority.* The registry should apply a fixed, consistent set of rules to make decisions to accept or reject notices and to identify notices in response to a search request. Finally, the registrar's office should not verify the information entered. The burden is on the registrant to provide correct information. If the registrant provides inaccurate information, the secured creditor risks losing its priority if the error makes the notice undiscoverable
- *Security of data and disaster recovery mechanisms.* The physical computer infrastructure must be housed in a stable, climate-controlled environment, in a secure location.²³ The main server should be backed up or replicated in another location to prevent the data from being damaged or lost.

In terms of the potential institutions that are usually capable of operating a movable collateral registry, these may include: the Central Bank, the Company Registry, the Credit Information Center or Credit Bureau, the Ministry of Finance, the Ministry of Industry and Trade. There are successful experiences in a number of countries in which the host institutions for the registry are

²³ *Publicity of Security Rights: Guiding Principles for the Development of a Charges Registry*, European Bank for Reconstruction and Development (EBRD), 2004, Annex: Technical Requirements for a Charges Registry, page 18.

the ones mentioned. This means that rather than focusing on a single best choice to locate the registry, the options should be open to existing institutions with the required capacity. While such systems are typically fully automated, human capacity for purposes of operating modern IT systems is required. It is important that whichever institution is mandated or chosen to operate the collateral registry has the infrastructure and financial capacity to operate the registry. Some jurisdictions choose to outsource the technical operations of the registry to a service provider, even though the data continues to be public data (unlike the data gathered by private credit bureaus). Many governments simply will not contemplate turning over operation of a registry to a private party.²⁴ Some are more amenable to this idea.²⁵ Each case will determine what the best options are in terms of institutional set up. The key aspect will be to create a registry which contains the main operating principles of a modern registry, and not which institution is in charge of managing it.

Finally, the other important aspect that needs to be analyzed with regard to the registration of security interests in movable property is the level of development of technology infrastructure in a country. There are two perspectives from which to assess a country's technology infrastructure and capacity to support an Internet-based registry. The first is the perspective of the registry, and the second is the perspective of the end user. *From the registry's perspective*, which is concerned with the ability of the infrastructure to meet the needs of an electronic registry, the important components are (i) connectivity with the Internet, (ii) presence of facilities to support registry hardware, and (iii) availability of people with the right skill sets to support the technology components. *From the end user's perspective*, the key question is whether all potential users of the registry's services have access to the Internet in some fashion. The potential users whose needs must be considered include banks, inventory financiers such as manufacturers and wholesalers, buyers of farm products, lessor, non-bank financial institutions (NBFI) and the public at large. If users do not have access across the country, it will be necessary to provide intake points (through private providers with internet access or public offices) in outlying regions to which users who do not have access may take paper documents, either for entry as data via the Internet from the intake points or for transmission to the central registry location via fax or some other means.

In the MENA region, the concepts behind security interests notice filing are not well understood. As of yet, there are no registries in MENA that function as modern notice filing collateral registries. MENA is the only region worldwide which has not yet managed to create a modern collateral registry system. Several of the countries in the MENA region have registries as

²⁴ *Secured Transactions Systems and Collateral Registries*, IFC, January 2010, C. 1. 1.1 Capabilities of Government to Operate Registry, and Private Sector Alternatives, page 63.

²⁵ In Egypt, the credit bureau (Iscore) is a private entity, and has been given the mandate to create and manage the collateral registry.

depositories of some types of collateral: the “Registre de Credit et Commerce Mobilier” (RCCM) in the civil law countries of the Maghreb or the Company Registry in some of the countries with a common and/or Islamic law system (Saudi Arabia, UAE, Yemen). These registries are very limited if we compare them with the notice based registry described and are usually inefficient in serving the purpose of a modern collateral registry. Where movable collateral registries exist, they tend to exist to “validate” or “stamp” loan agreements, but they do not otherwise promote effective notice to other lenders, or assist in creating execution rights and priorities over collateral. If there is a dispute over the terms of the contract, a certified copy can be retrieved. Thus it assists litigation, rather than lenders trying to assess their risk or assert their priority in an asset.

When we compare the main principles that a modern registry should be governed by with the existent infrastructure in MENA, the lack of modern systems sticks out as a major gap (see Table 7). First of all, none of the registries in MENA are notice based registries. They tend to be depositories for documents and serve no useful purpose for publicizing security interests in movable property or determining the priority of creditors. The majority of these registries are decentralized (except for the ones in Kuwait, Lebanon, Oman and West Bank & Gaza), meaning that the data is registered in different locations depending where the asset or creditor is located within the country. If we add the decentralization aspect to the fact that most of the registries in MENA are paper based and not electronic systems (Kuwait seems to have the only fully electronic registry in the region), we can assume that most of these registries are not searchable by the public and they do not assist lenders or borrowers in establishing priority among security interests held by multiple lenders. Finally, as illustrated in the table below, most of these registries limit the registration to a few types of movables (equipment, enterprise pledges, etc) and do not present a comprehensive picture of the different types of security rights that exist. A number of the MENA countries have a diversity of registries depending on the type of movable that is secured (vehicles, floating charges, trademarks, securities, enterprise charges, etc.).

Table 7: Mapping of Collateral Registries

Country	Collateral Registry	Centralized	Electronic or paper based	Easily accessible to public for searches
Algeria	Various (Centre National du Registre du Commerce only for Natissements sur fond de commerce)	N	Paper	N
Bahrain	Commercial Registry for Pledges over shares and floating charges over business assets; Traffic Directorate for pledges over vehicles; Bahrain Civil Aviation Authority for mortgages over planes; Bahrain Stock Exchange for Pledges over shares in publicly listed companies	Yes for commercial registry	Semi-electronic	-
Egypt	Various	N	Paper	Some
Iran	Various	N	Paper	-
Iraq	N	N	-	-
Jordan	N	N	Paper	Some
Kuwait	The department of authentication in the Ministry of Justice	Y	Electronic	-
Lebanon	Vehicles, RCCM	Y	Electronic / Paper	-
Libya	-	-	-	-
Morocco	Various, RCCM (fond de commerce)	N	Paper	Some
Oman	Commercial mortgages over assets registered at the Ministry of Commerce and Industry (MOCI). Charges over shares registered with the Muscat Depository and Securities Registration Company (MDSRC).	Y	Paper / Electronic	-
Qatar	Vehicles	N	-	-
Saudi Arabia	Various	N	Paper	-
Syria	N	-	-	-
Tunisia	Various, RCCM	N	Paper	-
UAE	N for movable collateral	N	-	-
West Bank & Gaza	Vehicles	Y	Electronic	N
Yemen	N	-	-	-

Source: *Doing Business* 2010

Despite the lack of modern asset registries in the region, banks do not seem to be particularly worried about the registration of security interests in property, especially when it comes to registering mortgages on immovable assets. Only 16% of banks consider the registration of mortgages problematic, while almost 50% of banks consider the registration of security interests in movable property a key constraint (see Table 8). One would expect that given the lack of modern registries in the region, the percentages for registering movable property should be higher than 50%. Possible explanations for this are: (i) the relatively modest use by financial institutions in the region of movable property registries (given the fact that movable property is only taken as complementary or secondary collateral), and; (ii) the general lack of knowledge from financial institutions (specially domestic banks) on how good functioning registry systems work elsewhere.

Table 8: How Problematic is it for Banks in the MENA Region to Register Interests in Property?

Region	Percentage of Banks Reporting Problems Registering Rights on Assets	
	Movable	Immovable
MENA Average	49%	16%
GCC Countries	56%	19%
Non GCC Countries	43%	14%

Source: World Bank MENA SME Lending Survey, 2010

To conclude with what the situation is in MENA with regard to technology infrastructure, there is no reason to believe that the infrastructure limitations in MENA preclude the development of effective registries. In MENA's middle income countries, internet use is widespread enough to suggest that the infrastructure necessary for an electronic registry sharing data across multiple locations is feasible. Internet penetration is reported to be 28.3% overall in the Middle East, with variation among countries: Bahrain at 55.3%, Iran at 48.5%, Qatar at 52.3% and UAE at 60.9% having the highest penetration, and Yemen the lowest at 1.6%, with others in-between.²⁶ This penetration rate is higher than the penetration rate in Africa (8.7%) and Asia (20.1%) and is above the average world rate (26.6%).

As previously stated, currently in MENA, the understanding of the modern collateral registry function is not widespread. Public education will be needed to change the view of registration as a two-party contract validation. Banks, leasing companies and other lenders will need to express a demand for and willingness to use the collateral registry in order for the government to be motivated to create modern ones, and for it to continue in operation so that it is a reliable long-term record of secured interests. They will also need to understand the nature of the registry, the

²⁶ <http://www.internetworldstats.com/links10.htm>; statistics on internet penetration.

notice function, the applicability to third party interests and the determination of priority of lenders and claimants.²⁷

2.5 *Priority Scheme for Creditors*

Priority of claims, such as security interests in property, determines the sequence in which competing claims to the collateral will be satisfied when the debtor defaults on one or more of the claims. An effective priority system is based on two main components; (i) a clear public policy underlying each priority; and (ii) a clear set of rules regulating the order of priorities to facilitate the implementation of these public policies. The general priority rule used in modern secured transactions systems is based on notice and on the “first to register rule” (meaning the first to register or otherwise perfect has priority) and a series of specific rules designed to serve overriding commercial or social purposes. Such rules create exceptions to the basic priority rule by giving preferential treatment to holders of certain interests in the collateral, including purchase-credit providers (in order to promote the extension of trade credit) and buyers of goods in the ordinary course of business (in order to facilitate commercial activities). Additionally, creditors holding non-consensual liens in the collateral by virtue of a statute or judicial process (e.g., the tax authority, a judgment lien holder, holder of a statutory lien, or insolvency administrators) should be subject to the same “first in time, first in priority” rule.

Laws and regulations in the MENA countries do not seem to provide a clear and favorable regime for creditors when it comes to establishing priority. The table below illustrates the lack of systems in MENA that place secured creditors on top of the list when it comes to priority in recovering assets and debts outside of bankruptcy, and how it compares with other regions (MENA is second worst performer). Although, it is arguable that secured creditors should always have absolute priority, what is critical for MENA is for countries to have a clear scheme of what the priority position of creditors will be so that they can properly assess the risks associated with taking collateral as security.

²⁷ Experience of some reformers in the region suggests that these factors are crucial, and are present or absent in varying degrees in the countries in the region where donors are working to reform secured transactions systems and establish collateral registries.

**Table 9: Priority of Secured Creditors vis a vis Others Creditors in
MENA and Regional Comparison**

Secured Creditors Have Priority Over Statutory Claims (Taxes and Wages)				Secured Creditors Do Not Have Priority Over Statutory Claims (Taxes and Wages)			
Iraq and Jordan				Algeria, Bahrain, Egypt, Iran, Kuwait, Lebanon, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia, UEA, West Bank and Gaza, Yemen			
	East Asia & Pacific	Europe & Central Asia	High income: OECD	Latin America & Caribbean	Middle East & North Africa	South Asia	Sub-Saharan Africa
Legal Right Index (0-10)	5.7	6.6	6.8	5.5	3.3	5.3	4.6
Absolute priority outside bankruptcy	58.3	75.0	59.1	38.1	16.7	14.3	25.6
Absolute priority in bankruptcy	33.3	71.4	59.1	4.8	11.1	14.3	15.4
Average	61.7	65.4	67.3	45.2	29.4	54.3	49.5

Source: Doing Business 2010

2.6 Enforcement of security interests: seizure of secured assets in cases of loan default

Speedy, effective, and inexpensive enforcement mechanisms are essential to realizing security interests. Enforcement is most effective when parties can agree on rights and remedies upon default, including seizure and sale of the collateral outside the judicial process. Reasonable safeguards against creditor misbehavior should be adopted to ensure that self-help remedies are exercised peacefully and that commercially fair value is obtained through private sale of the collateral. When the seizure and disposition of the collateral does call for judicial intervention, expedited summary legal proceedings should limit judicial findings to the existence of agreement granting the security interest and of an event of default. An efficient procedure is particularly important in the context of movable property, which in most cases depreciates in value over time. Despite the importance of this part of the process, enforcement/execution is often the weakest link in the chain in the system of secured transactions. Difficulty in execution is often reported as a significant barrier to access to credit.

A modern secured transactions law will need to include provisions related to the following enforcement principles:

Out of Court Enforcement Procedures

Seizure of the Collateral by the Secured Creditor. The main aspect related to this principle is the possibility for the secured creditor to seize the secured asset in case of default. Ideally, the enforcement law should allow the secured party to the security agreement to perform enforcement without court assistance. Under this procedure the secured creditor takes the property from the debtor without the assistance of the execution office. The creditor should have access through the law to speedy seizure procedure. The timing for removing the property from the control of the defaulting person is critical, as the property can be relocated, hidden or damaged. Delays in the process of enforcement can cause depreciation of the property value. Some jurisdictions have a pre-judgment procedure where, upon presentation of proof of the security agreement and an act or omission constituting default by the creditor, the court issues an order of seizure of the property without the possibility for appeal by the person in control of the property until after seizure is completed. In other systems, the proof may be simply by sworn affidavit of the creditor. This process is recommended, particularly for jurisdictions with lengthy court proceedings. According to the 2010 WB *Doing Business* Report, more than 100 jurisdictions today accept the possibility of enforcing security interests in movable property out of court.

In relation to collateral execution, the primary ways in which the law may provide for a secured creditor to recover the secured asset without resort to judicial process are seizure by the secured creditor or by a specialized agent.²⁸ International practices on how the asset is repossessed in practice varies and a number of countries have found different solutions that work more or less well (see Box 3 for examples).

²⁸ The simplest way is for the debtor to provide permission in the original contract for seizure upon default, to avoid court, if the company recognizes such a clause in an agreement. When such a norm was introduced in Slovakia, the enforceability of mortgages greatly improved. A more encompassing way is to create a legal right to non-judicial seizure/foreclosure. Many countries find giving creditors such a right under the law a political or ideological difficulty. The actual repossession of the asset/s in order to sell it is a critical part of the enforcement process.

Box 3: Different Extrajudicial Models for Seizing Assets Upon Default

Different countries have chosen different techniques to seize assets from debtors that have incurred in a default. The context of each country will determine what the best way to organize the seizure of assets is.

Public Collection Agents. A number of countries have created public collection agents that are responsible for seizing the asset with the appropriate executory title or judgement. These public collection agents are usually part of the executive branch (police forces or bailiffs) but not associated with the courts. The courts may also have judicial officers responsible for seizing assets when the enforcement process is done through the judiciary. The approach of using public collection agents is widely used in former Soviet Union countries.

Private Collection Agents. Other jurisdictions have established organized bodies or private enforcement agents that can vary from notaries (in Romania), private enforcement officers (Georgia) to bailiffs or huissiers (in France), to receivers (in the UK). These bodies are usually regulated and certified or licensed to avoid abuses, and determine the procedure that needs to be used for the seizure of the asset and the rights of both parties.

Combination of Public and Private Agents. Some countries have a hybrid system in which different agents perform different enforcement functions. In Slovakia, notaries are allowed to enforce mortgages and collateral agreements notarized by them, while public enforcement agents are used for other enforcement cases.

Many countries will be wary and fear abuse by actors not controlled by the government. The remedy with private enforcement agents is regulation, with significant penalties for abuse of debtors' rights. Private enforcement agents have been introduced in transition economies. Many countries in Eastern Europe have moved to such a model, after overcoming public and political doubts, such as Bulgaria, which implemented a system that created private enforcement agents, and left the public enforcement system in place. Other countries have implemented similar systems (see Box 4).

Box 4: Private Enforcement Experiences Worldwide: A Political Compromise²⁹ Bulgaria

As Bulgaria moved toward EU integration in the early/mid 2000s, the need to improve its debt enforcement system was obvious. Its deficiencies were considered a significant detriment to credit access. A USAID-funded project worked with Bulgarian experts and a plan to develop private enforcement specialists was developed. It faced significant opposition, both in public perception and by the public system that faced displacement of its role.

Through Herculean public education efforts, and intense, prolonged negotiations with stakeholders, a compromise was reached and the public system was left in place while a private system was also created.

²⁹ Interviews with reformers and http://bulgaria.usaid.gov/589/news_item.html.

The competition between the two systems was expected to motivate performance and provide users access to better services. Prior to the reform, enforcement backlog exceeded 360,000 cases. 30,000 cases were filed with private agents between May and November 2006, 3,500 had been finalized by January 2007. The system has become a model for other reforming systems.

The Kyrgyz Republic has similarly introduced a system that will include both private and State enforcement officers; in fact, Kyrgyz reformers visited Bulgaria to interact with their counterparts and learn from the Bulgarian experience in designing their own system.³⁰

In **Macedonia**³¹, Bulgaria's Balkan neighbor, the system to enforce judgments was privatized (law passed in 2005), with good results—according to the U.S. State Department, between January and July 2008, the total debt collected through the Macedonian private enforcement system was \$42.2 million. Further, out of the 30,657 cases filed from January to August, enforcement agents disposed of 15,355, which was 31 percent more efficient than the previous enforcement system. Macedonia's average time to dispose of an enforcement case is now 60 days, making Macedonia a regional leader and significantly improving its business climate.

In **Slovakia**, after the introduction of a secured transactions reform, and specific reforms making enforcement procedures more efficient through the introduction of the Law on Auctions, the time needed to foreclose on a mortgage decreased from 560 days to 45 days.³²

In **Romania**, in 1999 banks were authorized to hire and employ enforcement agents that had to be registered with the Ministry of Justice and had to comply with certain formalities, such as a close supervision to ensure lawfulness of the process. An assessment carried out a few years later showed that after the introduction of such reforms, the execution of bank debt related cases had significantly improved.

In **India**, the Securitization Act of 2003 now permits financial institutions and housing finance companies, which account for 90% of lending, to enforce security out of court. Further, time to recover collateral has dropped from 10 years to nine months, and banks reported that non-performing loans have fallen.³³

Alternative Dispute Resolution (ADR). Out of court enforcement mechanisms can include the execution through the financial institutions and other specialized institutions or through Alternative Dispute Resolution (ADR) Mechanisms, such as arbitration or mediation. The use of such mechanisms to enforce the payment of debts or seize assets secured as collateral is limited to those countries which have developed both the legal/regulatory and institutional framework for these mechanisms to be effective. Likewise, some countries, e.g. Colombia, have developed legal frameworks for mediation/conciliation in which the settlement agreement of a conciliation

³⁰ Interview with reformer involved with the Kyrgyz project.

³¹ U.S. State Department page on FY2008 assistance operations in Macedonia: <http://www.state.gov/p/eur/rls/rpt/seedfy08/117521.htm>.

³² See "Secured Transactions Reform and Access to Credit", Frederique Dahan and John Simpson. Elgar Financial Law Series, 2009.

³³ Doing Business Database, 2005, World Bank.

(signed by both parties) has the same value as a court order. Others countries that have successfully established ADR structures to resolve these types of disputes are Serbia, Bosnia-Herzegovina, Montenegro and Pakistan. A country with the right ADR framework in place can benefit tremendously from these mechanisms to enforce debt, as illustrated in the case of Colombia (Box 5).

Box 5: Banco Caja Social in Colombia: Recovering Assets Through Conciliation³⁴

In 2006, Banco Caja Social (the bank) initiated, on a pilot basis, a conciliation process to recover non-performing loans from clients, in addition to the bank's established use of collection houses and litigation. After the completion of the pilot, the bank realized that the conciliation mechanisms had produced a much more effective outcome in the recovery of small amount loans than the other two methods.

While the effectiveness of recovering assets from non-performing loans through litigations is around 1%, the effectiveness has increased to around 6% using conciliation. The time spent by bank staff trying to recover the loan and associated costs has also been reduced by using conciliation. With regard to the effectiveness of conciliation, only around 8% of the conciliation cases between the creditor (Banco Caja Social) and the debtors/clients held (around 9,000) between 2006 and 2008 were not settled.

In MENA, unfortunately, the examples of out of court enforcement procedures are virtually inexistent. Only three countries allow out of court procedures in their legislation (Bahrain, Iran, and Qatar), but there is no evidence of how the process works in practice. In Jordan, the new Leasing Law enacted in 2008 introduced out of court procedures to repossess leased assets, however it is not clear at this stage if the government of Jordan will be willing to expand the application of this mechanism to the enforcement of other security interests in movable property beyond leasing. Enforcement of debts, however, has been identified as one of the major constraints that hamper access to finance. A number of studies and surveys have shown that enforcement is constantly mentioned by creditors as a major issue. In terms of ADR initiatives, some countries like Morocco and Egypt have established mechanisms in the recent past, but as far as collection of debts is concerned, there is still no evidence that these mechanisms are being used. When compared across regions, MENA is also clearly lagging very far behind other regions (16% vs. 33% in Latin America which is the second worst), with very restrictive frameworks for allowing the recovery of debts outside of the formal judicial system (see Table 10).

³⁴ See "Private Sector Approach to Commercial ADR: Commercial ADR Mechanisms in Colombia", Alejandro Alvarez de la Campa, March 2009. The World Bank Group.

Table 10: Out of Court Enforcement in MENA vs. Other Regions

	East Asia & Pacific	Europe & Central Asia	High income: OECD	Latin America & Caribbean	Middle East & North Africa	South Asia	Sub- Saharan Africa
Legal Right Index (0-10)	5.7	6.6	6.8	5.5	3.3	5.3	4.6
Out of Court Enforcement Allowed	58.3	75.0	77.3	33.3	16.7	85.7	41.0
Average	61.7	65.4	67.3	45.2	29.4	54.3	49.5

Enforcement through the Court System

Enforcement of security through courts is of course a last resort for a creditor. Before enforcing, a lender is likely to have considered if any action short of enforcement will resolve the issue of non-payment, such as: (i) a refinancing; (ii) the provision of additional finance, security or other credit enhancement, either by the lender or by an outside party; (iii) a restructuring, which might involve an extension of payment terms or in more serious cases a writing-off or conversion into equity of some of the debt. Having considered these possibilities, the lender would usually (although not always) try to opt for the out of court enforcement mechanisms if available, and only if none of these options have worked or are available, the creditor will opt for taking the borrower to court to recover the debt.

When a jurisdiction does not provide for out of court enforcement, or when a creditor decides to enforce its security interest through a judicial procedure, the judicial process for recovery of collateral should be expeditious enough to permit recovery before loss of value of the assets and without undue risk of concealment or surreptitious sale of the assets by the debtor. A modern secured transactions law should include specific fast-track judicial procedures for the seizure of movable collateral. Some jurisdictions have a pre-judgment procedure by which, upon presentation of proof of the security agreement and an act or omission constituting default by the creditor, the court issues an order of seizure of the property without the possibility for appeal by the person in control of the property until after seizure is completed.

While execution proceedings are designed to allow secured creditors to enforce their rights efficiently, protection of debtors' rights shall also be included. There are three provisions to protect debtors' rights that should be included in any reformed execution proceedings: 1) the right to appeal against the enforcement proceedings; 2) The right to be notified of the proposed

disposition of the property, and; 3) The right of redemption (to keep the property after paying the outstanding obligation).

The MENA region is almost exclusively dependent on court-based enforcement. Even the DIFC in Dubai, which adopted relatively modern laws within its small area of jurisdiction, relies exclusively on judicial enforcement. As mentioned earlier, only Bahrain, Iran and Qatar allow out of court enforcement.³⁵ In some civil law countries like Tunisia, the fast track processes in court for the recovery of debts (“injonction de payer”) which are “certain, liquid and due” (like checks for example), seem to be working quite well, so it could serve as a model for other countries in the region. In Egypt there are expedited court procedures for certifying collection matters, in order to allow a creditor to begin the process of seizure more quickly than if a full court proceeding was required. However, after the court order, if indeed it works and the order is granted relatively quickly, the procedure to seize and sell assets can be as problematic as elsewhere in the region.³⁶ In Palestine, as well, there are expedited proceedings for urgent matters, but they are rarely used in practice since the matter is subject to review by a regular first instance judge. Neither are there specific courts in Palestine to consider summary proceedings or competent commercial circuits. Morocco, Jordan, Lebanon, Oman and UAE all report court enforcement that is time-consuming, expensive and unpredictable.³⁷ Delay tactics by debtors are common, and opportunities for objection are numerous.³⁸

Table 11: Percentage of Banks in MENA that Consider Enforcement of Secured Assets a Major Constraint

Region	Problems in Enforcing Rights on Assets	
	Immovable	Movable
MENA Average	58%	36%
GCC Countries	59%	29%
Non GCC Countries	56%	43%

Source: World Bank MENA SME Lending Survey, 2010

2.7 Enforcement of security interests: sale of assets in cases of default

Disposition of the seized property by the secured creditor is an important element in efficient enforcement mechanisms. The secured creditor, rather than a court enforcement officer, should

³⁵ *Doing Business 2010*

³⁶ Observations based on interviews with Egyptian attorneys and judges.

³⁷ *Hawkamah Report*

³⁸ Delay by debtors, and numerous opportunities to object are common problems reported worldwide by systems attempting to reform their enforcement systems. These problems are symptomatic of court-centered enforcement/debt collection.

be permitted to dispose of the property because the secured creditor is more likely than the enforcement officer to be familiar with the resale market for the property. The secured creditor is also motivated to sell it for a price that will cover the outstanding obligation.

Another aspect of enforcement is the method of disposition of collateral. In many countries the collateral must be sold by public or judicial auction, often court-controlled, with cumbersome procedures, and minimum bids. Court auctions are generally the least effective method of selling and maximizing the value of pledged assets.³⁹ The preference under modern practice is for the secured creditor to be allowed to dispose of the property through a private sale. Requiring an auction not only delays the sale, thus allowing devaluation of the assets, it also may not be appropriate for the type of assets involved—for example, there may be a very small market, or niche market, such as for biotech assets. Further, often minimum bids are required based on “market value” of the asset. Evaluations to determine minimum bids are of questionable reliability, and fail to account for the auction price, which is lower than fair market value. An auction that fails to bring a minimum bid not only delays the sale; it also allows the asset value to deteriorate.⁴⁰ Therefore, it is important in a modern secured transactions regime to allow the creditor to decide on the method of disposition. Another option, more commonly used, is to allow the creditor to take the collateral in satisfaction of the debt, which leaves the creditor free to dispose of it as he sees fit.⁴¹

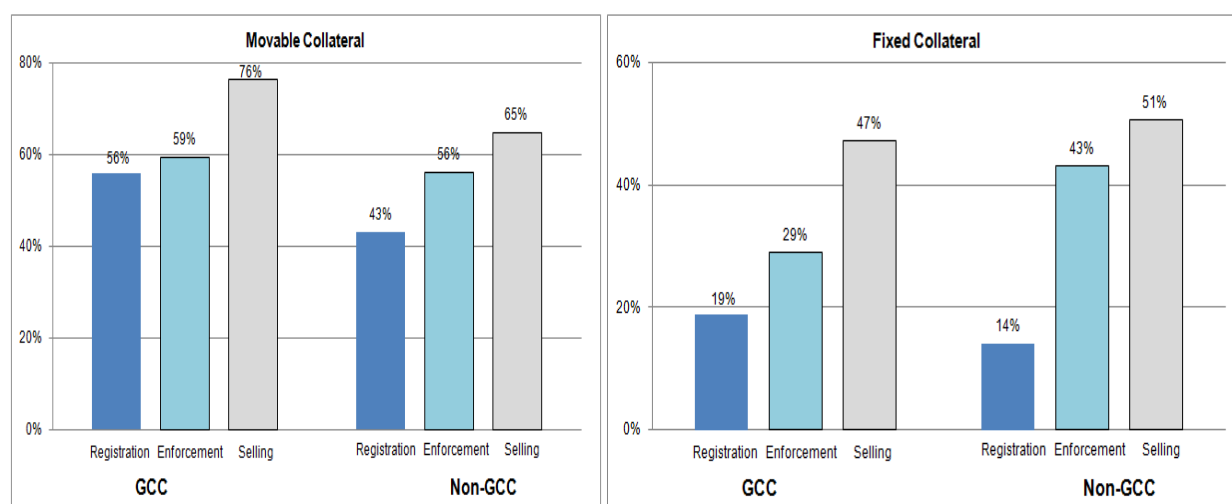
In MENA, the disposition of secured assets is one of the major constraints to financial institutions (see Figure 3). The data provided in Figure 3 is for both immovable assets and movable property. However, while both represent a constraint, movable property is clearly more difficult to sell (71% of banks consider it a major constraint) after a default and a repossession of the asset, than immovable assets (49% consider it a major impediment). The figure also illustrates how the process of recovering a debt secured with collateral becomes more challenging at the enforcement and execution phases, which is clearly one of the reasons why secured transactions has not properly developed in the MENA region.

³⁹ *Secured Transactions Systems and Collateral Registries*, IFC, January 2010, 2.2.5 Enforcement of a security interest 3. Disposition of the secured asset/s, page 57: Disposition is important, and it is preferred that the secured creditor, rather than a court enforcement officer, dispose of the collateral.

⁴⁰ The problems with minimum bids and appraisals and repeated sales have been recounted by reformers in several countries during interviews with experts assessing the systems of collateral execution.

⁴¹ The option to allow the creditor to take the collateral in satisfaction of the debt has been reported by various countries to interviewers assessing the collateral execution systems.

Figure 3: Percentage of Banks that Consider the Registration, Enforcement, and Sale of Secured Assets (Movable and Immovable) a Major Constraint



The most common trend in MENA is for creditors to dispose of the asset by public auction (either through the court or some other execution institutions assigned to facilitate the sale of the asset). Private sales of secured assets are rare, as they are usually associated with extrajudicial enforcement mechanisms, which are restricted to three countries in the region. In Jordan, the sale of movable assets is done by auction, via the Execution Department of the court. In Morocco, assets need to be evaluated by an assessor before they are put for sale in a public auction; creditors find the pricing process arbitrary, and the auction procedure non-transparent. Moroccan creditors have also complained about the lack of court understanding of commercial matters. In Kuwait, after maturity of the debt, if the parties agree, the creditor can take the pledged collateral in satisfaction of the debt with the judge's permission, effectively allowing the creditor to control its sale. It should be noted that in Kuwait, a debtor can slow down enforcement proceedings by objecting and challenging auction proceedings when the disposition is undertaken by the court.⁴² In Qatar, the Execution Court of the Civil Courts controls execution, presumably including disposition of the collateral.⁴³ As of 2004, in both Tunisia and Algeria, it appeared that there were provisions in the law that appeared to recognize the possibility of a private sale, but a creditor could not seize his property without court permission, nor could he sell it at public auction without court permission.⁴⁴

⁴² *Hawkamah Report*, Chapter 9 Kuwait.

⁴³ Qatar reports that there has been little in the way of enforcement of securities in recent years.

⁴⁴ *Legal Benchmarks for Monitoring Implementation of Euro-Mediterranean Association Agreements*, Draft August 5, 2004, unpublished, Annex 4c Secured Lending, Tunisia, Algeria.

2.8 *Summary of Findings and Recommendations*

Creditor protection through modern secured transactions legal regimes is associated with higher ratios of higher private sector credit to GDP. **Increasing the protection of creditor's rights and enforcement mechanisms can lead to a considerable increase in private sector credit to GDP.**⁴⁵ As evidenced by numerous sources of data such as the World Bank Enterprise surveys, the Legal Rights Index of the Doing Business Report and the recent World Bank MENA SME Lending Survey, the MENA region lags clearly behind the rest of the world in firms' access to private credit and in the robustness of secured transactions systems.

In the World Bank's Enterprise Surveys, **the MENA region had the lowest percentage of firms with credit lines or loans from financial institutions**, at 25.07%, compared to 56.92% for Eastern Europe and Central Asia (ECA), 54.97% for Latin American & the Caribbean (LAC), and 45.02% for South Asia. Moreover, enterprise survey data from 7 countries in MENA points out that **collateral requirements for firms requesting loans are substantial**. On average, 82% of loans require some type of collateral. Improving secured transactions regimes has helped alleviate this constraint in other countries and can reasonably be expected to do the same for the MENA countries.

Modern and efficient secured transactions systems have the objective of facilitating lending to firms, especially SMEs by creating the conditions for firms to be able to use movable property as collateral for loans. Modern secured transactions systems are built around the **following principles or pillars**:

- **Scope:** the types of legal structures that can be used to secure obligations (e.g. security interest, pledge, mortgage, etc.); the types of transactions that should be considered within the scope of the law (loans secured with movable property, retention of title, financial leasing, assignment of receivables, consignments, etc); the types of movable property that may be used as security; and the types of debtors who may give security in movable property.
- **Creation:** the legal requirements for giving and taking a right against movable property to secure an obligation.
- **Priority:** the rules that determine the relative rights among conflicting claims against movable property.
- **Publicity/registration of security interests:** the means of making a claim against movable property transparent to third parties, commonly provided by registration in a public registry, by taking possession or control of the movable property, by direct notice,

⁴⁵ See "Private Credit in 129 Countries", Simeon Djankov, Caralee McLiesh and Andrei Schleifer, 2006.

or by other means. An efficient registry is characterized by having a single electronic database with all information about existing security interests in movable property, accessible to the general public for a reasonable fee in real time.

- **Enforcement:** the process for enforcing a claim against movable property when the debtor defaults on the secured obligation. Enforcement mechanisms should include the possibility of enforcing out of court.

None of the MENA countries have introduced secured transactions legal reforms, and none of them have developed modern movable collateral registries. Most of the countries have obsolete and fragmented secured transactions provisions governed by different laws that have not been reformed in many years. The MENA region ranks last in the cross-region comparison for Legal Rights Index, and the MENA country that scores best is in position 106 overall. All of these factors have a considerable impact on access to credit for firms, especially SMEs, that are deprived of using the majority of their valuable movable assets to secure credit.

It is recommended that reforms in the MENA region be undertaken to improve the secured transactions system focusing on: (i) improving the legal and regulatory frameworks for secured transactions based on standard international accepted practices; (ii) developing modern electronic collateral registries, and; (iii) creating awareness about the concept of modern secured transactions among the main public and private sector stakeholders. Given the complexity of providing an overview of the secured transactions system in each country limiting the paper to a manageable size, the report focuses on general principles and how they are applied in the region. Clearly, a future reform of this area in a specific MENA jurisdiction would require a more substantive analysis of the current state of things with regard to each of these principles.

When revising secured transactions frameworks, countries in MENA should take into account the main principles for an effective system. The region has a unique opportunity to reform some of the obsolete concepts on secured financing that originate in unreformed civil and commercial codes that have been modeled from one country to the other and therefore share a lot of similarities. Based on this, it would also be highly recommended to undertake reforms in this area using a standardized approach when it comes to the main principles, so that cross financing secured with movables in the region can properly develop. Finally, the more appropriate way to address the reform would be by **creating a specific law on secured transactions that regulates every aspect of a secured transactions system, moving away from the current system of fragmented provisions in different bodies of the law (Civil Codes, Commercial Codes, Mortgage Laws, Debt Recovery, etc).** A number of countries with both civil (Romania, Albania, Cambodia, China, Bosnia) and common law (Ghana, India, Australia, New Zealand) systems have introduced very successful reforms in this area following the modern secured

transactions principles described. Therefore, the type of legal system of a country should not be a deterrent to introducing reforms in this area.

In the secured transactions reform, special **emphasis should be given to the following elements:**

- **Broadening the scope of the secured transactions laws.** This reform should focus on areas such as: (i) Allowing broad pools of assets (revolving assets) with a generic description of the assets to be accepted as collateral. Currently, none of the MENA countries allow for the use of broad pool of assets with no specific description of each asset to be used as collateral, restricting the development of inventory and receivables financing. (ii) Adopting the “functional approach” to secured transactions, which should allow equal treatment to all transactions secured by movable property no matter what the nature of them is (financial leases, consignments, assignment of receivables, secured sales contracts, loans secured with movable property, retention of title, etc.) with regard to publicity and priority vis a vis third parties. This is a critical concept to avoid having a system with hidden liens due to the lack of publicity of some of them. Most countries currently treat some of the transactions secured with movable property (such as financial leases or long term operational leases) under a different regime by which these transactions do not have to be registered in a public registry.
- **Simplifying the creation of security interests in movable property.** Eliminating cumbersome and unnecessary formalities for the creation and enforceability of security interests in movable property. These formalities tend not to add any value, but usually increase the cost of the transactions which end up being reflected in an increased cost of credit. The general practice should be to allow the parties to freely agree on the conditions of the transaction in the credit agreement. Currently, a number of MENA countries require unnecessary formalities to create and enforce security interests in movable property.
- **Modernizing movable collateral registries.** The collateral registry is the cornerstone of a functioning and efficient secured transactions system. Without a functioning registry, the best secured transactions law in the world would be completely ineffective and useless. The registry fulfills an essential function of the system which is to notify parties about the existence of a security interest in movable property (of existing liens) and to establish the priority of creditors vis a vis third parties. None of the countries in MENA have modernized their secured transactions registry in line with standard internationally accepted practices. Therefore, collateral registries in MENA usually lack the critical features of a modern registry: centralization in a single database, electronic web-based system, registration of notices, accessibility to the general public for real time consultations, unified registry for all types of movable assets, cost effectiveness, restrictions on the authority of registrar, security of data, etc.

- **Establishing a clear priority scheme for secured creditors.** Granting secured creditors a predictable level of priority is an essential feature to promote lending to firms. Secured creditors should be able to predict their priority vis-à-vis other creditors at the moment of granting a loan to a business. This increased predictability and transparency could lead banks to provide longer term credit and at better interest rates. Currently, according to the Doing Business Report 2010, the MENA region is the second worst region worldwide when it comes to a clear and favorable priority scheme for creditors.
- **Improving enforcement mechanisms.** Enforcement and collection of debts upon defaulted loans is possibly the major impediment for increasing access to credit in the MENA region. Speedy, effective, and inexpensive enforcement mechanisms are essential to realizing security interests. Enforcement is most effective when parties can agree on rights and remedies upon default, including seizure and sale of the collateral outside the judicial process. An efficient procedure is particularly important in the context of movable property, which in most cases depreciates in value over time. Despite the importance of this part of the lending process, enforcement/execution is often the weakest link in the chain in the system of secured transactions. In the case of MENA, enforcement mechanisms are also, along with collateral registries, the weakest link in the chain. According to the Doing Business Report 2010, only 3 countries in MENA allow for out of court enforcement mechanisms. **The MENA region ranks last in the easiness for enforcing debts out of court.** More than 100 countries worldwide allow in their legislation to enforce security interests on movable property out of court. In 2010, almost 60% of financial institutions in the region consider the enforcement of security interests in movable property as a major impediment to granting credit to firms.⁴⁶ Both the seizure and sale of assets are currently very challenging processes in MENA.
- **It is highly recommended that MENA countries introduce reforms in the enforcement procedures of the different jurisdictions to align the region with international best practices.** The reform of enforcement procedures and in particular the introduction of out of court enforcement procedures has had a considerable impact in lending in a number of countries (India, Romania, Slovakia), sometimes by introducing private enforcement agents and regulated out of court enforcement. A variety of policy options are available to the governments, ranging from: (i) introducing new extrajudicial mechanisms to enforce debts; (ii) introducing fast track or expeditious procedures in court for debt collection processes; (iii) improving the capacity of existing institutions through the use of ADR or strengthening execution agencies; (iv) improving the mechanisms available to financial institutions to sale the secured assets, by granting more freedom in the disposition method (private sale or public auction).

⁴⁶ According to the 2010 World Bank MENA SME Lending Survey to Financial Institutions.

A reform of secured transactions systems in MENA would have multiple beneficiaries. Businesses, especially SMEs, are logically the most obvious one, as they would considerably expand their options of accessing credit using movable property as collateral. A reform in this area would also incentivize **banks and NBFIs** to provide additional lending to SMEs. A modern secured transaction system increases competition in the financial sector, as NBFIs would have a friendlier environment to develop asset based financing. **Regulators and the government** would also see potential benefits in implementing reforms in this area, as it would contribute to increasing access to credit and reducing the cost of credit (therefore allowing firms with more access to create employment), but also to contribute to a more robust financial system, with more transparency and predictability.

Finally, consideration should be given to raising the awareness in the region about the importance of secured transactions in increasing access to credit. Lack of training and awareness about the benefits of modern secured transactions systems were identified as one of the most important hindrances for the growth of credit to SMEs in MENA. Training and awareness could be focused on the various stakeholder groups, and could vary depending on the target group. The various target groups could include: (i) public sector stakeholders, registry staff, execution officers, judges, etc.; (ii) financial institutions and NBFIs, and; (iii) the business community.

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Annex 1

UNCITRAL's Recommendations for the Scope of a Secured Transactions Law

A secured transactions law should apply to all rights in movable assets created by agreement that secure payment or other performance of an obligation, regardless of the form of the transaction, the type of the movable asset, the status of the grantor or secured creditor or the nature of the secured obligation.

The law should apply to:

- (a) Security rights in all types of movable asset, tangible or intangible, present or future, including inventory, equipment and other tangible assets, contractual and non-contractual receivables, contractual non-monetary claims, negotiable instruments, negotiable documents, rights to payment of funds credited to a bank account, rights to receive the proceeds under an independent undertaking and intellectual property;
- (b) Security rights created or acquired by all legal and natural persons, including consumers, without, however, affecting rights under consumer-protection legislation;
- (c) Security rights securing all types of obligation, present or future, determined or determinable, including fluctuating obligations and obligations described in a generic way; and
- (d) All property rights created contractually to secure the payment or other performance of an obligation, including transfers of title to tangible assets for security purposes or assignments of receivables for security purposes, the various forms of retention-of-title sales and financial leases

The law should not apply to:

- (a) Aircraft, railway rolling stock, space objects, ships, as well as other categories of mobile equipment in so far as such asset is covered by a national law or an international agreement to which the state enacting legislation based on these recommendations (herein referred to as “the State” or “this State”) is a party and the matters covered by this law are addressed in that national law or international agreement;
- (b) Intellectual property in so far as the provisions of the law are inconsistent with national law or international agreements, to which the State is a party, relating to intellectual property;
- (c) Securities;
- (d) Payment rights arising under or from financial contracts governed by netting agreements, except a receivable owed on the termination of all outstanding transactions; and
- (e) Payment rights arising under or from foreign exchange transactions.

The law should not apply to immovable property except insofar as its application to fixtures may affect rights in the immovable property to which a fixture may be affixed.